

Tax Incentives for Health Insurance Premiums

Background

Tax incentives for premium payments are either tax credits or deductions from income for amounts paid for insurance premiums, either by employers or employees.

For federal purposes, generally a self-employed individual can deduct 60% of health insurance premiums paid (for year 2000 tax returns). This percentage will increase to 100% in 2003. There are some net income limitations to the deduction. The remaining 40% can be deducted as a medical expense on federal Schedule A, subject to the 7.5% medical floor. A self-employed person includes Schedule C filers plus partners in a partnership and more than 2% shareholders in an S-Corp. For a partner or shareholder to deduct the premiums, they must include premiums paid for them in taxable income. For example, for a 100% shareholder in an S-corporation, the S-corporation pays \$1000 in premiums and deducts them on the corporate tax return. The shareholder includes the \$1000 on their federal return as taxable income, then deducts \$600 in arriving at adjusted gross income, and \$400 on Schedule A. An employee may not deduct any premiums paid, other than on Schedule A.

For Wisconsin purposes, self-employed persons can deduct 100% of their health insurance premiums (subject to net income limitations). Therefore, in the above example, the taxpayer would take a Wisconsin subtraction modification for the \$400 that is not deductible on the federal return, and would remove the \$400 from medical expenses on Schedule A when calculating the itemized deduction credit. Wisconsin also allows employees to deduct 50% of health insurance premiums, PROVIDED the employer does not contribute any amount of the premium. The 50% deduction is taken as a subtraction modification on Form 1, and medical expenses on Schedule A are reduced accordingly. For example, a state employee who subscribes to the standard plan for health care, or subscribes to an HMO where the state doesn't pay 100% of the premiums, cannot take a 50% deduction for premiums paid because the state contributes some amount to the premiums.

Co-pays and deductibles can only be claimed as a medical expense on Schedule A, subject to the 7.5% floor.

Other states have tried to implement tax credits or incentives regarding health insurance premiums. Kansas enacted a tax credit plan for 2000. The plan gives small employers a \$35/employee/month credit that declines after the first year and is gone after the fifth year. Missouri has proposed something similar this year, except that they give a 50% credit that declines to 25% in the fourth year. Their credit does not terminate however. Also, only new health plans will get 50% initially. Existing plans

will start out at a 25% credit. Georgia's legislature saw two bills in 2000 that addressed taxes. One was for a deduction for premiums paid, the other was a tax credit for premiums paid. Neither bill made it out of committee.

Tax incentives are very popular with advocacy groups. Many organizations make the claim that employer based health plans are discriminatory in that employees receive a tax free benefit while the uninsured, the ones who could use the benefit the most, do not receive any tax benefit that would help defray the cost of their premiums.

There is currently a bill introduced in the Assembly (Assembly Bill 51) that would allow that the 50% deduction for health premiums where the employer pays none of the premium to be raised to 100%

Options

1. Advocate for federal tax law changes including individual tax credits for insurance premiums or income deductions for premium payments. Also, a lowering or elimination of the 7.5% itemized deduction limitation should be considered.

Pro

- Tax incentives are very popular. In the 106th Congress there were nine different bills introduced that offered tax credits or deductions for health insurance premiums. None of them passed. In the current 107th Congress there are already two bills currently introduced that address the tax incentives for premium payments. There is also talk of adding some sort of tax incentive for insurance premiums to the tax cut plan President Bush has submitted to Congress or to a Patients Bill of Rights proposal.

Cons

- Federal tax credits or deductions are difficult to get through Congress.
 - The task force can only advocate changes to the federal government. Real ability to effect change is limited.
2. Allow for an addition to Wisconsin itemized deduction credit calculation for the medical expenses that are not allowed on the federal Schedule A due to the 7.5% minimum
 3. Allow a tax credit for premiums paid to insurance companies for employers and employees for the actual premiums they pay. The credit could be refundable or non-refundable. The credit could also be income based, becoming smaller as income goes up.

4. Allow for a straight subtraction modification from Wisconsin income for premiums paid for health insurance.

The following list of pros and cons would apply to options 2 through 4.

Pros

- Tax credits or deductions would defray the cost of premiums paid
- Tax credits will encourage more employers to offer health insurance
- Tax credits will allow more individuals to purchase insurance

Cons

- Additional Wisconsin tax incentives may result in a significant cost to the state at a time of significant budgetary constraints.
- Tax incentives may not be of a scope large enough to significantly aid small employers.
- Tax cuts do not address the problem of rising premiums directly.